



Power Machines

Company
Note

BUY

Upside: 26%
Target Price: \$0.245

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Stock data

Ticker	SILM	M.Cap, \$ mn	1,654.7
Shares Ords	8,708,938,708	Free float	19.6%
Shares Prefs	-	Free float, \$ mn	324.3
Bid Ords, \$	0.189	Offer Ords, \$	0.191

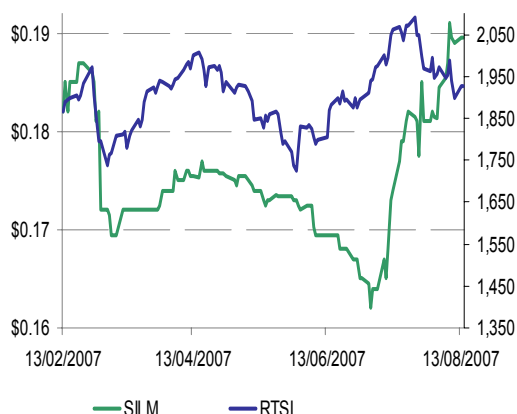
Market performance

		1 month	6 months
Absolute	Ords	8.76%	4.05%
Relative to RTSI	Ords	15.23%	0.79%
Price range, \$			
High	Ords	0.190	0.190
Low	Ords	0.177	0.165

Financials, 2007E

Revenue, \$ mn	939.3	P/S	1.76
EBITDA, \$ mn	62.1	EV/EBITDA	30.85
Net income, \$ mn	-22.7	P/E	NEG.

Power Machines – Relative performance



Source: RTS, Sovlink

A powerful leap forward

- The rise of the Russian power sector will also be beneficial to companies in other sectors associated with it, as part of the 3 billion roubles earmarked for investment in the power sector will be invested in them. We consider Power Machines as one of the most promising companies in its sector and expect its share price to increase in the near future – based on sound operational results due to increased orders from power companies, its recent SPO and the anticipated battle between strategic investors to gain control of the company. We have calculated a year-end target price of \$0.245 for the company's shares, implying potential upside of 26% from the current price of \$ 0.191. Accordingly, we initiate coverage of Power Machines by issuing a **BUY** recommendation.
- UES' power generating companies plan to spend 695 bn roubles for the purchase of equipment by 2011. We assume that one third of the OGKs' and TGKs' orders will be placed with Power Machines. While the company cannot compete with international turbine producers for thermoelectric power stations, it is the clear market leader in the production of equipment for HPPs (hydro power plants) and NPPs (nuclear power plants). This will allow Power Machines to double its current sales volume by 2011, and treble its sales figures to \$3 bn by 2016.
- The planned investment programme of \$1.2 bn by 2011 will help the company keep up with the demands of the power companies. As a result, the company's production capacity will increase by 4,500 MW to 12,500 MW by 2011, and by 2015 it will be double its 2006 capacity of 8,000 MW. The company will focus on the most developed equipment sectors such as steam turbines and generators, and will produce 160-270 MW gas turbines jointly with Siemens.
- The battle to win control of the company amongst strategic investors – rather than the company's future plans – will be the main force driving Power Machine's price higher in the near future. According to media reports, Severstal's Aleksey Mordashev, Basic Element and Renova are all vying for control of the company. The competition between strategic investors and the resultant premium to the market price that they will be willing to pay in order to win control, will not only attract market interest, but also benefit the remaining minority shareholders who will be offered the same premium for their shares.

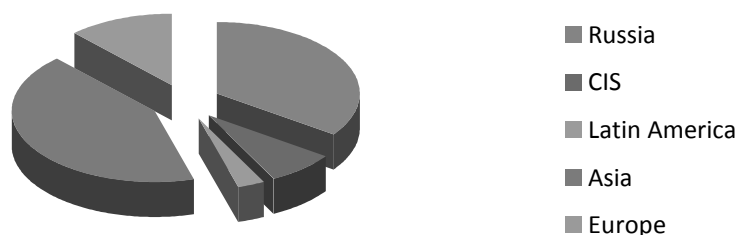
Power Machines – current position

Power Machines was established in 2000 and became the leading Russian producer and supplier of integrated solutions in the power engineering, applied engineering, production, supply, assembly, service, and equipment modernisation sectors for thermal, atomic, hydraulic and gas turbine power stations. In 2004, the Leningradsky Metallichesky Zavod, Electrosila, the Turbine Blade Plant, and Energomachexport were incorporated into Power Machines. In addition the company sells the products of the Kaluzhskiy Turbine Factory (KTZ) and plans to acquire as many of its shares as it can, and owns a stake of 35.27% in the Power Engineering Research and Design Institute (NPO CKTI).

The company produces steam turbines with capacities of up to 1,200 MW, hydraulic turbines with capacities from 4 to 750 MW, 160 MW gas turbines (under licence to Siemens), blades for the gas turbines, and generators. KTZ produces steam and gas turbines with capacities up to 35 MW.

The company's products are distributed in Russia (32%), CIS (7%), Latin America (3%), Asia (39%), Europe (11%), and other markets (8%). In 2006, Power Machines' had total orders worth \$1.8 bn, including contracts worth \$669.8 mn signed during the year.

Sales markets



Source: Company data

By the time that UES acquired an equity stake in the company, it had already prepared a comprehensive investment programme for the power sector – although the details were published a year later. UES wanted to gain influence over Power Machines, which supplied 80% of the equipment used by power companies in Russia.

In December 2005, UES bought a stake of 22.4% in Power Machines for \$101.4 mn from Interros, acquiring the right to control 30.4% of the company. Within three months, UES' stake was valued in the market at \$170 mn as the company's price on the RTS increased by 70%. To date the company's capitalization since the transaction has increased by 120% to \$1.3 bn.

UES played a major role in the rapid increase in the company's capitalisation – by immediately acquiring the company's assets, changing its management, arranging a technical audit of the company (carried out by experts from Siemens), creating a gas turbine division managed by specialists from Germany, and instructing its sub-divisions to help the management of the company's loss-making departments.

Significant staff changes were made by Boris Vainzikh, who transferred from UES to become the company's general manager in September 2006 (while continuing to work part-time at UES). At UES his main role was to develop the overall disposal scheme of the power companies in Russia up to 2020 – including UES' investment programme. There are rumours that he now wants to work exclusively in the power engineering sector and will resign from his job in UES.

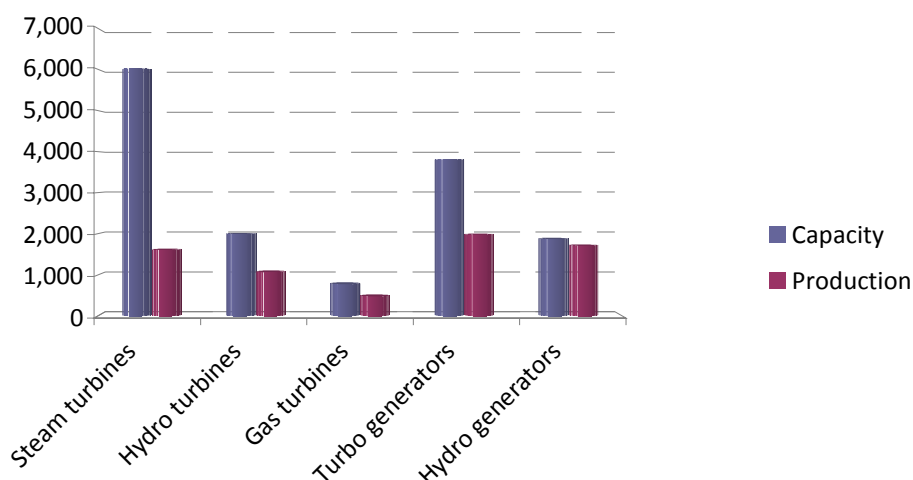
One of UES' self-appointed tasks is to raise Power Machines' quality levels to those of leading comparable global producers in the heavy engineering sector. In order to do this, UES has attracted managers from highly-rated international companies. In October 2006, Alexander Chuvaev (who had worked previously at GE) was appointed the company's managing director and in November Thomas Fitting (previously at Siemens) was appointed as the director in charge of the gas turbine division.



Financial results and production capabilities

So far, although the company's capitalisation has grown significantly, the company's financial results have failed to impress. In 2006, the company manufactured steam turbines with capacities of less than 500MW for a total capacity of 1,610 MW, gas turbines with total capacity of 480 MW, hydraulic turbines with total capacity of 1,070 MW and turbo generators with total capacity of 1,980 MW.

2006 production capacity, MW



Source: Company data

Due to the length of time required to produce a turbine – 18-30 months, depending on its power capacity and type: for example, 300 MW steam turbines require 22-27 months – the company already knows the minimum number of orders for certain types of equipment in 2007-08.

Type of equipment	Contracts, GW	
	2007E	2008E
Steam turbines < 500 MW	2.7	4.4
160 MW gas turbines	0.7	0.7
Hydro turbines	2.3	2.6
Total	5.7	7.7

Source: Company data

According to the company's 2006 IFRS accounts, its revenues fell by 13% y-o-y from \$667 to \$579 mn, net losses increased 3.26 times to \$132.2 mn. The company explained the fall in its revenues as a peculiarity of its discount policies and the changes in the structure of its contracts' portfolio. With growing demand for power engineering products from utility companies, the company is concentrating on long-term contracts for basic equipment, which are more profitable than short-term contracts – that are predominantly for spare parts and service contracts.

The main reason for the company's losses is related to its export contracts, which turned out to be more expensive than initially estimated: in addition to orders from Russian power companies, Power Machines signed contracts with foreign companies without adequately accounting for the higher metal prices and currency volatility that followed. This concerned, for the most part, contracts with the Indian companies Sipat and Barx and the Vietnamese company



Wont Bi, which were concluded by the company in order to penetrate these markets. The IFRS financial statements of the company showed losses of \$90 mn resulting from these contracts.

However, in April 2007 – in its report to UES – the company used different figures: according to these figures, foreign contracts led to losses of greater than \$130 mn.

In the table below we have provided detailed information on the company's losses:

Contract	Contract amount, \$ mn	Actual losses, \$ mn	Delay in implementation
Barx (India)	232.8	29.6	11 months
Sipat (India)	209.7	88.2	9 months
Jerdap-1 (Serbia)	63.0	1.7	15 months
Aswan (Egypt)	60.3	16.8	17 months

Source: Interfax

The company estimates that it could potentially reduce its losses by \$50 mn by taking the required cost-minimising measures. The company is counting on avoiding further losses by better analysis, planning, implementation and control of its policies, staff training with respect to client relations, reviewing its policies with suppliers and sub-contractors, carrying out investment programmes, and reviewing the type of contracts it uses and the way in which it formulates its prices.

Financial problems have, in some cases, led to the breach of credit clauses with western banks. In particular, covenants were broken with Donau-Bank and Eurasia Commerce Bank with respect to loans that were scheduled to be repaid in 2009. The company took out both these loans last year: as of December 31, 2006, the company owed 20 mn euros to Donau-Bank and \$30 mn to Eurasia Commerce Bank. Management considers it unlikely that the banks will exercise their right to demand the early repayment of the loans as a result of the company having infringed the credit covenants. The company's IFRS statements mention that Power Machines expects to receive letters from the banks confirming that they will demand early repayment.

The company's investment programme and strategy

The company's new management has developed a long-term strategy in relation to UES' investment programme and its plan to develop an atomic branch. The company has detailed two scenarios: in one scenario the company's production capacity increases by 15-20% per annum and in the other by 25-30%.

In the table below we have presented the company's forecasts under both scenarios for the period up to 2010:

Income summary

	2007E	Scenario 1 – 2009E	Scenario 2 – 2009E
Revenues, \$ mn	1,032	1,400	1,600
Investment, \$ mn	145.6	Up to 100	200-250
EBIT margin	5%	7%	11%
Contracts	1,780	2,400	2,900
Return on capital	5%	9%	14%

Source: Interfax, UES

In order to motivate management to achieve these targets, the company has initiated a performance-related bonus system.

Key operational indicators

Indicator	2007E	2010E	2015E
Sales Volume, \$ mn	925	2,000	3,000
Gross profit margin	20%	25%	26%
Production capacity, GW	8.8	12.5	17.0
% due to service sector	10%	12%	15%
% due to export markets	70%	40%	40%

Source: Interfax, UES

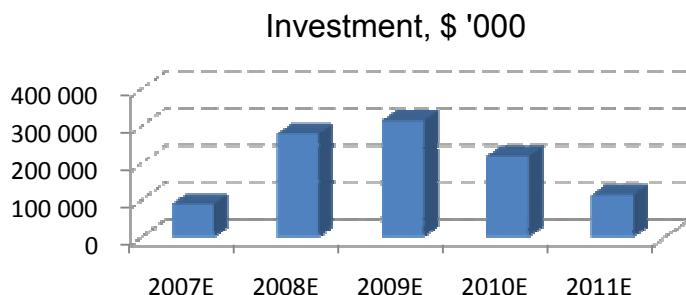


According to the company’s general director, Boris Vainzikher, the company aims to maintain domestic market share of 60-70% in the steam turbine sector, 30-40% in the gas turbine sector and 100% of the hydro turbine and hydro-generator markets.

In order to meet the rapidly rising demand from power companies, the company has decided to increase its production capacities. The company plans to produce steam turbines and turbo generators with power ratings of over 500 MW for the bigger coal production units and NPPs, and also to produce gas turbines. This project is scheduled to be completed between 2013 and 2015, with an estimated investment of \$1.2 bn. The company expects the bulk of the investment (\$1 bn) to be made between 2007 and 2010. The average pay-back period is estimated to be three years, although it could take as long as 5-7 years for some projects – depending on the scale of the production facilities, the time required for its construction/assembly and the preparatory work required. The successful implementation of the programme should lead to sales volumes of at least \$3 bn by 2015 – on condition that the company maintains at least 60% of its Russian contracts and receives at least 15% from its service and modernisation contracts in Russia and abroad.

The company also plans to spend \$50 mn in research and development and for the acquisition of KTZ’s shares. This results in a total investment of \$1 bn by 2010.

Investment breakdown per annum

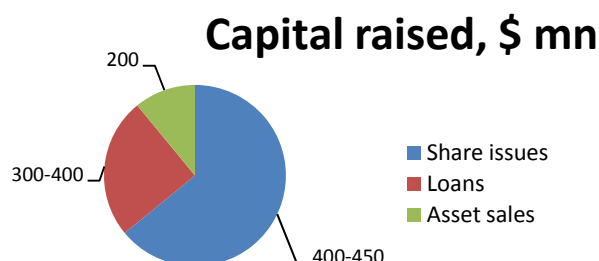


\$ '000	2007E	2008E	2009E	2010E	2011E
Investment	91,000	280,000	315,000	220,000	115,000

Source: Company estimates

The company will raise capital for its investment programme, primarily through the issue of additional shares, loans and the sale of assets. Power Machines plans to sell land owned by it in St.Petersburg after transferring some of its facilities to the Pskov region.

In the near future, we expect positive results from the investments made by UES.



Source: Company data



SPO and strategic battle

The company recently completed the first of two additional share issues. In the first stage, the company issued 1.492 bn additional ordinary shares with a par value of 0.01 roubles per share. Three of the company's largest shareholders – UES, Interros and Siemens – bought over 80% of the shares by exercising their pre-emptive rights. Consequently, approximately 20% of the shares placed are available to other investors (or about 4% of the increased authorised share capital of the company). Troika Dialog managed the issue. The company's board set the issue price at \$0.184 per share, which at that time was slightly above the market price. As a result the company raised \$275 mn.

According to media reports, demand for the additional shares exceeded the amount issued. In our opinion, the unsatisfied demand taken together with the fact that only 20% of the issue was available to ordinary investors will boost the price of the company's shares on the secondary market.

The company plans to hold the second issue in 2008, in order to raise a total of about \$450 mn (together with the amount raised via the SPO).

After the capital raising process starts, UES plans to sell its stake in the company, as UES itself will be liquidated by July 1, 2008 as a result of the reforms being carried out in the energy industry. Aleksey Mordashev, the main shareholder of Severstal, has indicated an interest in acquiring UES' stake as well as Interros' stake in the company – which would give him a controlling stake in the company. Mordashev has written to the Federal Antimonopoly Service (FAS), requesting permission to bid for a 100% stake in the company. In addition, Basic Element belonging to Oleg Deribaska and Renova (controlled by Viktor Vekselberg) have also indicated their interest in acquiring a controlling stake in the company. (Siemens also has stated its interest in acquiring a controlling stake in the company, despite the company's decision to sell a controlling stake to a Russian strategic partner.)

UES had planned to sell its stake in 1H08, but its board is now considering selling their stake immediately after the completion of the first additional issue. On August 31, the UES management will decide on the details of the sale.

Interros has already – without waiting for UES' decision – agreed to sell its stake to an anonymous buyer. Media reports hint that A. Mordashev has bought Interros' stake. However, apart from Mordashev, Basic Element also applied to FAS for permission to bid for an 82% stake in the company. It is interesting to note that following Basic Element's application, FAS decided to extend the review period for Mordashev's application: although they had not mentioned any complications at the time of the application.

It appears that a fierce battle is being waged for UES' stake – without which the new shareholders cannot acquire a controlling stake in Power Machines. This could lead to a significant premium being paid by the company which finally acquires control of Power Machines.

Contracts from UES and the nuclear industry

Power Machines is a company worth struggling for. UES' large-scale investment programme – that was confirmed in February – calls for the construction of 40,900 energy production facilities in Russia by 2011. UES' power generating companies plan to invest over 1.6 trillion roubles in the project. Of this amount, the OGKs and TGKs will spend 694.9 bn roubles to purchase equipment, which will result in their orders growing from 29.8 bn roubles in 2006 to 212.4 bn roubles in 2010.

“There is demand throughout the sector, led by Power Machines”, commented Anatoly Chubais, the head of UES, with respect to the figures mentioned above.

Anatoly Chubais promised to give preference to Russian companies if their offer is comparable to foreign companies involved in the tender, especially the price/quality terms offered. In our opinion, Power Machines will win one third of the orders from the OGKs and TGKs and the company will need to work at full capacity.

Power Machines' general director, Boris Vainzikher, has stated that if the company's production capacity doesn't meet demand, they will consider cooperating with other companies (both Russian and foreign) to meet demand.

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The company's production capacity in 2006-10 as well as orders for equipment from UES' power generating companies:

Production capacity, MW	2006	2010E	UES orders
Turbines – Total	8,800	11,000	31,860
Steam turbines	6,020	7,000	23,500
Water turbines	2,000	3,000	5,063
Gas turbines –160	780	~920	3,300
Generators – Total	5,685	8,500	46,225
Turbo generators	3,808	5,000	44,800
Hydraulic turbine generator	1,877	3,500	1,425

Source: UES estimates, Company data

If Power Machines manages to obtain the license from Siemens for gas turbines with a capacity of 270 MW, which are needed for the OGK/TGK construction projects (by 2011 the power generating companies are forecast to need a number of such turbines with a total capacity of 9,200 MW), then the company's orders will be much higher.

The initial projects of the OGK/TGK energy holding demonstrate UES' intention to support the Russian power engineering industry. The company has already obtained orders from OGK-3 for the construction of a 225 MW power generating unit in Kharanorskoy GRES as well as two new 225 MW power generating units in Cherepovetskoy GRES, from Mosenergo for the construction of three CCGT-450 units and from OGK-6.

It is possible that the flow of contracts from UES' subsidiaries will subside after private investors acquire control of UES' (former) subsidiaries. Our suspicions based on Mosenergo's example, which declined to issue new contracts to Power Machines (preferring to work with Alstom instead) as soon as Gazprom acquired a controlling stake in Mosenergo. Mosenergo's management argued that foreign products are more energy-efficient. However, the services of global power engineering producers are needed not only by Russian OGKs and TGKs – as in Russia (to a greater extent than in other countries) an energy deficit already exists as opposed to an expected energy deficit – consequently, the production time-frame is as important as the price/quality relationship.

Furthermore, regarding the supply of thermal heating station equipment, Power Machines could lose market share to international producers such as Alstom, Siemens, and GE, as their products are often cheaper. However, in the hydro generation sector, the Russian company is the undisputed leader. Power Machines was selected as the supplier for all the large projects implemented by HydroOGK: namely, Zagorskaya GAES-2, Bureiskaya GES, Boguchanskaya GES and the complete reconstruction of the hydropower plants of the Volga-Kama River Cascade

Demand for the company's products is ensured not only on orders from UES. Power Machines is practically the only high-speed turbine producer for NPPs, whereas its global peers produce low-speed turbines. For example, Rosatom wants to purchase both high-speed and low-speed turbines in order to construct 26 power generating units – this effectively ensures that the company will receive at least 10 of these orders for powerful turbines. However, whereas the boom in the traditional power construction sector has already started, the boom in the nuclear power construction sector in Russia is scheduled to begin in 2010. Currently, one NPP is being built per year in Russia – from 2010 onwards, we expect two NPPs to be constructed each year.

The task of modernising the existing NPPs has also been assigned to Power Machines, as atomic reactors have been constructed and repaired by them since Soviet times.

The difference between high-speed and low-speed turbines lies in the revolutions per minute attained by their motors – high-speed turbines are usually twice as fast. Industry experts consider low-speed turbines to be more cost effective as they conserve heat more efficiently, whereas high-speed turbines are more reliable. The company has the opportunity to expand its product range to include low-speed turbines. Sergey Kirienko, the head of Rosatom, commenting on plans to create local companies in Russia in collaboration with foreign power construction companies for the assembly of low-speed turbines, specifically mentioned that existing Russian companies such as Power Machines are welcome to take part in this process.

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The ambitious plans of the Russian atomic sector to increase Russian companies' share in foreign markets will also have a positive influence on Power Machines. The company supplies turbines practically for all reactors, which are currently built abroad by Atomstroyexport. It is therefore realistic to assume that it will continue to receive these orders in future. Atomstroyexport is currently involved in constructing two new 1,000 MW NPPs in Tienvan (China) in addition to the two NPPs already built, four new NPPs in Kudankulam (India), and is participating in the tender to build the next NPPs following the first NPP in Bysher (Iran).

SWOT Analysis

Disadvantages	Advantages
<p>The lack of a license for the production of 270 MW gas turbines on which the CCGT unit is based and which are going to be built by the OGKs.</p> <p>Technologically less developed than its international peers, with comparable prices.</p> <p>Three of the largest shareholders have conflicting interests, which harms the company's development.</p> <p>Negative financial results due to poor management and external factors.</p>	<p>The company enjoys a monopoly on the production of some types of equipment in the domestic market.</p> <p>The company's association with UES practically guarantees orders from the power generating companies and atomic power plants.</p>
Risks	Opportunities
<p>It may not be possible for Power Machines to negotiate a license agreement for the production of 270 MW gas turbines with Siemens or other international producers; as a result, the company may lose potential orders from OGKs to its rivals, leading to lower revenues.</p> <p>Potential buyers' of UES' stake can use administrative resources to negotiate a cheap price.</p> <p>Different strategic investors can buy UES' and Interros' stakes, which means that the conflict of interest amongst Power Machine's three major shareholders will continue to hinder the company's development.</p> <p>It is possible that the company may not be able to handle the volume of orders it receives, leading to fines for supply disruptions and losses.</p> <p>The OGKs and TGKs – after privatisation – could start working with international producers.</p>	<p>The company has initiated a new ambitious investment programme, which aims to increase its production capacity and modernise its technology.</p> <p>The prospect of the appearance of a strategic investor interested in developing the company.</p> <p>Competition between potential investors in buying UES' stake will boost the share price.</p> <p>There is global demand in the power machinery sector, and the sector leaders simply cannot cope with the order volume – leading to higher product prices.</p>



Valuation

A substantial part of the capital investment will take place between 2007-10, with a pay-back period of 3 years. Our DCF model, used to calculate the company's target price, takes into consideration contracts signed with UES and its subsidiaries between 2007-08 as well as contracts that UES has indicated will be assigned to the company between 2009-15.

We also used the company's forecasts regarding the growth in its production capacity up to 2015. We expect Power Machines to start producing high-energy turbines and power generators for large coal power plants in 2011 – the same year that coal is expected to become the primary fuel for new power stations and the rate of new nuclear power-generating units is expected to increase from one new unit per annum to two units. We also believe that a significant part of the company's planned investment will be absorbed by its high-energy steam turbine production division.

Capacity, MW	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Total turbines	8,800	8,800	9,900	11,000	14,334	15,667	17,000	17,000	17,000
Steam turbines >500 MW and generators					3,000	4,000	5,000	5,000	5,000
Steam turbines < 500 MW	6,020	6,020	6,510	7,000	6,667	6,334	6,000	6,000	6,000
Hydro turbines	2,000	2,000	2,500	3,000	3,000	3,000	3,000	3,000	3,000
Gas turbines	780	780	890	1,000	1,667	2,333	3,000	3,000	3,000
Total generators	6,308	6,750	7,525	8,300	9,333	10,667	12,000	12,000	12,000
Turbo generators	3,808	4,000	4,500	5,000	6,333	7,667	9,000	9,000	9,000
Hydro generators	2,500	2,750	3,025	3,300	3,000	3,000	3,000	3,000	3,000

Source: Company data, Sovlink estimates

UES' orders – mentioned above – are significantly greater than the company's existing production capacities, which is why we believe that Power Machines will function at over 90% of its production capacity from 2008 onwards.

Production, MW	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Total turbines	5,800	8,100	9,000	9,900	13,234	14,574	15,920	16,030	16,150
Steam turbines >500 MW and generators					2,850	3,800	4,750	4,750	4,750
Steam turbines < 500 MW	2,800	4,800	5,550	6,300	6,067	5,827	5,580	5,640	5,700
Hydro turbines	2,300	2,600	2,700	2,800	2,800	2,800	2,800	2,820	2,850
Gas turbines	700	700	795	890	1,517	2,147	2,790	2,820	2,850
Total generators	5,800	6,483	6,977	7,470	8,803	10,057	11,310	11,355	11,400
Turbo generators	3,500	3,883	4,267	4,650	5,953	7,207	8,460	8,505	8,550
Hydro generators	2,300	2,600	2,785	2,970	2,850	2,850	2,850	2,850	2,850

Source: Company data, Sovlink estimates

According to our information Power Machines, is going to use its steam turbine facilities to produce more hydro turbines than allowed by the company's current hydro turbine production capacity.

Our revenue forecasts are based on the company's current production capacities and future orders.

Revenue, \$ mn	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Total turbines	491.0	741.5	876.1	1,020.3	1,142.4	1,272.5	1,412.6	1,484.4	1,560.2
Steam turbines >500 MW and generators									
Steam turbines < 500 MW	294.0	524.2	630.3	744.1	745.2	744.4	741.4	779.3	819.1
Hydro turbines	92.0	108.2	116.8	126.0	131.0	136.3	141.7	148.4	156.0
Gas turbines	105.0	109.2	129.0	150.2	266.1	391.8	529.5	556.6	585.1
Total generators	231.5	268.1	304.8	344.0	435.8	534.1	639.5	668.2	698.2
Turbo generators	185.5	214.0	244.6	277.2	369.1	464.7	567.3	593.2	620.2
Hydro generators	46.0	54.1	60.2	66.8	66.7	69.3	72.1	75.0	78.0
Supplementary equipment	127.5	178.2	208.4	240.8	278.5	318.8	362.1	379.9	398.5
Services	89.3	124.8	153.5	186.0	235.8	281.9	334.1	365.1	398.5
Turbo revenue	722.5	1,009.6	1,180.9	1,364.3	1,578.2	1,806.5	2,052.1	2,152.6	2,258.3
Total revenue:	939.3	1,312.6	1,542.8	1,791.1	2,092.5	2,407.2	2,748.3	2,897.5	3,055.4

Source: Company data, Sovlink estimates



We expect service revenues to gradually increase from 11% of the company's total revenue to 15% by 2015, as stated by the company. At the same time we expect supplementary equipment revenue to amount to approximately 15% of total revenues.

Furthermore, we believe that Power Machines can cope with the losses expected from increases in the price of metals. Exchange rate volatility will also have less impact on the company as a result of its increased emphasis on domestic contracts rather than foreign contracts.

DCF valuation

In spite of the net losses presented in the company's annual reports in 2005-2006, we see outstanding prospects for the company in the period between 2009-15.

In our DCF model we have taken into consideration the \$23 mn announced losses for 1HO7 from contracts in Asia – these losses occurred as a result of the penalties charged due to supply delays. Excluding these penalties, we expect the company to be profitable in 2007.

We have also included the \$275 mn raised via the SPO earlier this year. We expect the company to invest the capital raised to increase its production capacity and refinance its current liabilities. The company plans to invest heavily in acquiring new equipment and modernising its existing equipment between 2008-09.

DCF Summary, \$ mn	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenues	667.2	579.1	939.3	1,312.6	1,542.8	1,791.1	2,092.5	2,407.2	2,748.3	2,897.5	3,055.4
COGS	-504.8	-583.4	-732.7	-1,010.7	-1,172.5	-1,343.3	-1,569.4	-1,793.4	-2,047.5	-2,144.1	-2,261.0
Gross profit	162.4	-4.3	206.6	301.9	370.3	447.8	523.1	613.8	700.8	753.3	794.4
Distribution expenses	-73.9	-54.6	-75.1	-85.3	-84.9	-89.6	-83.7	-96.3	-109.9	-123.1	-129.9
Administrative expenses	-96.7	-104.9	-109.9	-121.3	-129.0	-134.3	-141.2	-161.4	-174.0	-182.3	-192.2
EBITDA	25.1	-122.6	62.1	138.7	202.7	273.0	352.3	415.3	480.9	517.0	546.4
Amortization&depreciation	31.6	36.1	38.5	41.4	44.3	47.1	52.1	57.1	62.1	67.1	72.1
interest payments	-30.2	-28.7	-23.2	-25.7	-30.7	-38.2	-48.5	-60.7	-75.4	-90.9	-106.8
PBT	-46.8	-164.7	0.4	71.6	127.8	187.7	251.7	297.5	343.4	359.1	367.5
Net profit	-40.5	-132.4	-22.7	54.4	97.1	142.6	191.3	226.1	261.0	272.9	279.3
EBITDA margin, %	3.8%	-21.2%	6.6%	10.6%	13.1%	15.2%	16.8%	17.3%	17.5%	17.8%	17.9%
Net profit margin, %	-6.1%	-22.9%	-2.4%	4.1%	6.3%	8.0%	9.1%	9.4%	9.5%	9.4%	9.1%
FCFF											
EBITDA	25.1	-122.6	23.6	97.3	158.4	225.9	300.2	358.2	418.8	449.9	474.4
Taxes	-6.0	29.4	-5.7	-23.4	-38.0	-54.2	-72.0	-86.0	-100.5	-108.0	-113.8
Depreciation	31.6	36.1	38.5	41.4	44.3	47.1	52.1	57.1	62.1	67.1	72.1
Change in NWC	204.1	106.6	-120.6	-80.1	-40.4	-40.4	-50.6	-65.1	-72.2	-29.4	-33.3
Capex	-32.5	-15.4	-86.7	-75.3	-310.0	-214.7	-109.1	-74.2	-75.4	-72.1	-68.3
FCFF	222.3	34.1	-150.8	-40.0	-185.7	-36.3	120.5	190.0	232.7	307.5	331.0
FCFF discounted	-	-	-137.2	-33.2	-140.1	-24.9	75.3	108.1	120.6	145.0	142.1

Source: Company data, Sovlink estimates

WACC	9.85%
Terminal growth rate	3%
Projected NPV, \$ mn	255.69
NPV of terminal value, \$ mn	2,136.46
Fair EV, \$ mn	2,392.15
Net debt, \$ mn	262.00
Fair M.Cap, \$ mn	2,130.15
Shares outstanding, mn	8,708.94
Target price, \$	0.245

**WACC calculation**

Tax rate	24%
Cost of equity	12.11%
Cost of debt	8.50%
Debt	40%
Equity	60%
WACC	9.85%

Cost of equity calculation

Risk free	4.5%
Risk premium	7.0%
Country Risk premium	2.0%
Small cap premium	1.0%
Company Specific risk	0.5%
Beta unleveraged	0.39
Beta leveraged	0.59
Cost of equity	12.11%

Source: Bloomberg, Sovlink estimates

In order to improve the company's financial position, we assume management will maintain the company's current capital structure – equity (60%) and debt (40%) – for financing operations.

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Equity/Capital	52.87%	33.53%	60.04%	60.00%	59.99%	59.99%	60.00%	60.01%	60.02%	60.02%	59.99%
Gross Debt/Capital	47.13%	66.47%	39.96%	40.00%	40.01%	40.01%	40.00%	39.99%	39.98%	39.98%	40.01%

Source: Company data, Sovlink estimates

Accordingly, we initiate coverage of Power Machines by issuing a **BUY** recommendation, with a target price of \$0.245 per ordinary share, which offers potential upside of 26% from the company's current price of \$0.191.

Sensitivity analysis

We have provided sensitivity analysis by varying the WACC and terminal growth rates used in the DCF – as the fair value estimation is very heavily weighted on the terminal value. We note that changing the debt/equity ratio in the company's capital structure could lead to a lower target price. In our estimates, we used a conservative cost of debt rate of 8.5%, whereas the company's annual report indicated the company's average cost of debt at 7.04%

		WACC				
		7.85%	8.85%	9.85%	10.85%	11.85%
Terminal Growth	1%	0.291	0.231	0.185	0.150	0.122
	2%	0.343	0.267	0.211	0.169	0.136
	3%	0.416	0.315	0.245	0.193	0.154
	4%	0.528	0.383	0.289	0.224	0.176
	5%	0.717	0.486	0.353	0.266	0.205

Source: Sovlink estimates



Peer comparison

	P/S		P/E		EV/EBITDA		Country
	2007E	2007E	2008E	2007E	2008E	2008E	
Developed markets							
General Electric	2.53	18.35	16.20	22.62	19.77		USA
Alstom	1.35	24.06	18.85	9.28	7.73		France
Siemens	1.00	17.56	14.24	8.67	7.36		Germany
Mitsubishi Heavy Industries	0.90	46.01	42.44	14.04	11.59		Japan
<i>Average</i>	<i>1.45</i>	<i>26.49</i>	<i>22.93</i>	<i>13.65</i>	<i>11.61</i>		
Emerging markets							
Shanghai Electric Grp Co L-H	0.97	17.01	16.39	6.24	6.11		China
Harbin Power Equipment Co-H	0.55	13.99	13.62	4.87	4.66		China
Baoding Tianwei Baobian-A	8.02	95.19	45.56	14.92	7.91		China
Donfang Electrical Machines-A	7.45	30.12	27.86	5.15	5.07		China
Suzlon Energy Ltd	4.58	28.20	19.60	17.88	12.54		India
Bharat Heavy Electricals	4.90	27.08	20.99	10.73	8.26		India
<i>Average</i>	<i>4.41</i>	<i>35.27</i>	<i>24.00</i>	<i>9.96</i>	<i>7.42</i>		
Power Machines	1.78	-73.93	30.82	29.73	13.77		Russia

Source: Bloomberg, Sovlink estimates

As can be seen from the table above, Power Machines looks overpriced in comparison with its peers from both developed and emerging markets. We attribute this to losses from international contracts in Asia, which were planned incompetently. Furthermore, comparative analysis does not take into consideration future orders from UES and its subsidiaries. Nonetheless, the P/S multiple looks quite reasonable even in comparison with developed markets. We believe that the planned comprehensive capital investment in the company's production capacities and the future orders expected from UES will improve the company's earnings multiples over the next few years.



Appendix: IFRS financial statements

Income statement

\$ mn	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenue	667.20	579.10	939.30	1,312.61	1,542.78	1,791.09	2,092.54	2,407.24	2,748.26	2,897.47	3,055.41
Cost of sales	-504.80	-583.40	-732.65	-1,010.71	-1,172.51	-1,343.32	-1,569.40	-1,793.40	-2,047.45	-2,144.13	-2,261.00
Gross profit	162.40	-4.30	206.65	301.90	370.27	447.77	523.13	613.85	700.81	753.34	794.41
Distribution expenses	-73.93	-54.56	-75.14	-85.32	-84.85	-89.55	-83.70	-96.29	-109.93	-123.14	-129.85
Administrative expenses	-96.68	-104.94	-109.90	-121.29	-128.98	-134.33	-141.25	-161.41	-174.03	-182.25	-192.19
Other net operating income	1.68	5.16	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Total operating expenses	-168.93	-154.34	-183.04	-204.60	-211.83	-221.89	-222.95	-255.70	-281.96	-303.39	-320.04
Operating income	-6.53	-158.64	23.60	97.30	158.44	225.89	300.19	358.15	418.84	449.95	474.37
Amortization & Depreciation	31.58	36.07	38.53	41.40	44.27	47.13	52.12	57.10	62.08	67.07	72.05
EBITDA	25.05	-122.57	62.13	138.69	202.70	273.02	352.30	415.25	480.93	517.02	546.42
Interest expense	-30.25	-28.66	-23.18	-25.73	-30.68	-38.19	-48.46	-60.68	-75.43	-90.88	-106.83
Gain on exchange	-0.47	22.48	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Other income	-9.54	0.10	-23.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
PBT	-46.80	-164.71	0.42	71.56	127.76	187.69	251.72	297.47	343.42	359.07	367.54
Income tax	6.30	32.27	-0.10	-17.18	-30.66	-45.05	-60.41	-71.39	-82.42	-86.18	-88.21
Net income	-40.50	-132.44	-22.68	54.39	97.10	142.65	191.31	226.08	261.00	272.89	279.33

Source: Company data, Sovlink estimates

Balance sheet

\$ mn	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Assets											
PPE & investments	300.29	335.18	362.13	389.09	416.04	442.99	489.83	536.66	583.50	630.33	677.17
<i>Current assets</i>											
Inventories	91.56	125.23	139.20	181.93	199.33	214.93	235.41	269.01	307.12	321.62	339.15
Trade & other receivables	286.41	212.94	657.51	918.83	1,079.95	1,253.76	1,464.78	1,685.07	1,923.78	2,028.23	2,138.78
Other current assets	3.14	6.81	4.98	4.98	4.98	4.98	4.98	4.98	4.98	4.98	4.98
Cash & equivalents	34.48	40.92	102.17	69.57	147.51	301.17	505.85	753.76	1,069.18	1,447.60	1,834.40
Total assets	715.87	721.08	1,265.99	1,564.39	1,847.80	2,217.83	2,700.84	3,249.47	3,888.55	4,432.76	4,994.48
Liabilities											
Borrowings	119.15	57.22	32.40	79.09	231.39	437.33	557.13	676.87	835.55	1,005.08	1,149.51
Other long-term liabilities	40.49	23.78	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
<i>Current liabilities</i>											
Borrowings	117.21	246.31	240.31	223.63	129.54	12.00	13.04	37.03	51.82	64.08	107.27
Trade and other payables	155.91	150.72	563.58	787.57	925.67	1,074.65	1,255.52	1,444.35	1,648.95	1,738.48	1,833.24
Provisions	17.95	89.91	20.00	20.00	20.00	20.00	20.00	20.00	20.00	20.00	20.00
Total liabilities	450.69	567.94	856.28	1,110.29	1,306.60	1,543.99	1,845.69	2,178.25	2,556.33	2,827.64	3,110.03
Equity											
Issued capital	10.56	10.56	10.56	10.56	10.56	10.56	10.56	10.56	10.56	10.56	10.56
Additional paid-in capital	125.28	125.28	400.28	400.28	400.28	400.28	400.28	400.28	400.28	400.28	400.28
Translation reserve	25.89	45.93	50.00	40.00	30.00	20.00	10.00	0.00	0.00	0.00	0.00
Retained earnings	102.46	-29.76	-52.43	1.96	99.05	241.70	433.01	659.08	920.08	1,192.97	1,472.30
Minority interest	0.99	1.13	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
Total equity	265.18	153.14	409.71	454.10	541.19	673.84	855.15	1,071.23	1,332.22	1,605.12	1,884.45
Total liabilities & equity	715.87	721.08	1,265.99	1,564.39	1,847.80	2,217.83	2,700.84	3,249.47	3,888.55	4,432.76	4,994.48

Source: Company data, Sovlink estimates



Cash flow statement

\$ mn	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Net income	-40.50	-132.44	-22.68	54.39	97.10	142.65	191.31	226.08	261.00	272.89	279.33
Depreciation & Amortization	31.58	36.07	38.53	41.40	44.27	47.13	52.12	57.10	62.08	67.07	72.05
Loss on disposal of PPE	1.86	0.95	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Loss on disposal of intangible assets	0.91	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Gain on disposal of other assets	0.00	-2.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Gain on disposal of investments	-2.19	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Gain on disposal of subsidiaries	1.56	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Impairment of investments	2.28	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Amortisation of government grant	0.00	-3.81	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Income from associates	-0.01	-0.35	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Interest income	-6.71	-4.00	-	-	-	-	-	-	-	-	-
Interest expense	27.93	22.54	-	-	-	-	-	-	-	-	-
Net interest	-	-	23.18	25.73	30.68	38.19	48.46	60.68	75.43	90.88	106.83
Penalty provision	0.00	0.00	23.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Income tax	-6.30	-32.27	0.10	17.18	30.66	45.05	60.41	71.39	82.42	86.18	88.21
Unrealised foreign exchange gain	0.59	-7.69	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Operating profit before change in WC&P	10.99	-123.11	62.13	138.69	202.70	273.02	352.30	415.25	480.93	517.02	546.42
Increase in inventories	-7.33	-24.36	-13.97	-42.72	-17.40	-15.60	-20.48	-33.60	-38.11	-14.50	-17.53
Decrease in trade and other receivables	61.75	97.66	-444.57	-261.32	-161.12	-173.82	-211.02	-220.29	-238.71	-104.45	-110.56
Increase in trade and other payables	-45.15	40.28	412.86	223.99	138.10	148.99	180.87	188.82	204.61	89.53	94.76
Cash flow from operations before taxes and interest	20.26	-9.53	16.45	58.64	162.29	232.59	301.68	350.18	408.72	487.59	513.09
Interest paid	-27.17	-22.97	-23.18	-25.73	-30.68	-38.19	-48.46	-60.68	-75.43	-90.88	-106.83
Income tax paid	-40.65	-7.81	-0.10	-17.18	-30.66	-45.05	-60.41	-71.39	-82.42	-86.18	-88.21
Cash flow from operating activity	-47.57	-40.31	-29.83	15.73	100.95	149.35	192.80	218.11	250.87	310.54	318.06
Proceeds from disposal of PPE	2.47	5.08	4.35	4.67	4.99	5.32	5.88	6.44	7.00	7.56	8.13
Proceeds from disposal of other assets	0.00	2.70	0.00	200.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Acquisition of PPE and Intangibles	-34.94	-23.16	-91.00	-280.00	-315.00	-220.00	-115.00	-80.64	-82.45	-79.68	-76.39
<i>Total capital investment</i>	<i>-32.47</i>	<i>-15.37</i>	<i>-86.65</i>	<i>-75.33</i>	<i>-310.01</i>	<i>-214.68</i>	<i>-109.12</i>	<i>-74.20</i>	<i>-75.45</i>	<i>-72.12</i>	<i>-68.26</i>
Other investments	97.76	1.80	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Cash flow from investing activities	65.29	-13.57	-86.65	-75.33	-310.01	-214.68	-109.12	-74.20	-75.45	-72.12	-68.26
Net proceeds from borrowings	3.96	58.55	-97.00	27.00	287.00	219.00	121.00	104.00	140.00	140.00	137.00
Proceeds from borrowings	487.89	582.41	-	-	-	-	-	-	-	-	-
Repayments from borrowings	-483.93	-523.87	-	-	-	-	-	-	-	-	-
Proceeds from SPO	-	-	275.00	-	-	-	-	-	-	-	-
Cash flows from financing activities	3.96	58.55	178.00	27.00	287.00	219.00	121.00	104.00	140.00	140.00	137.00
Net increase in cash and cash equivalents	21.68	4.66	61.51	-32.60	77.94	153.66	204.68	247.91	315.42	378.42	386.80
Cash and cash equivalents at the beginning of year	12.93	34.50	40.66	102.17	69.57	147.51	301.17	505.85	753.76	1,069.18	1,447.60
Effect of exchange rate fluctuations	-0.11	1.49	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Cash and cash equivalents at year-end	34.50	40.66	102.17	69.57	147.51	301.17	505.85	753.76	1,069.18	1,447.60	1,834.40

Source: Company data, Sovlink estimates

STOCK RATING POLICY

STRONG BUY:	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
BUY:	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
HOLD:	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
SELL:	Fair value at or below current price levels

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